KPMG

EMMA PENDLETON BRADLEY HOSPITAL

Financial Statements

September 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

EMMA PENDLETON BRADLEY HOSPITAL

Statements of Financial Position

September 30, 2006 and 2005

(In thousands)

Assets	2006	2005
Current assets:		
Cash and cash equivalents	$ 2,545	$ 2,655
Patient accounts receivable	8,359	9,614
Less allowance for doubtful accounts	(1,914)	(2,414)
Net patient accounts receivable	6,445	7,200
Other receivables	443	881
Total receivables	6,888	8,081
Inventories	96	77
Prepaid expenses and other current assets	24	54
Total current assets	9,553	10,867
Interest in net assets of Bradley Hospital Foundation	360	180
Assets limited as to use	41,723	42,066
Property and equipment, net	14,401	12,474
Other noncurrent assets	51	177
Total assets	$ 66,088	$ 65,764

Liabilities and Net Assets	2006	2005
Current liabilities:		
Accounts payable	$ 397	$ 600
Accrued employee benefits and compensation	2,987	2,559
Other accrued expenses	789	656
Current portion of estimated third-party payor settlements	2,144	1,576
Estimated health care benefit self-insurance costs	578	444
Total current liabilities	6,895	5,835
Estimated third-party payor settlements, net of current portion	867	1,005
Other liabilities	1,497	3,999
Total liabilities	9,259	10,839
Net assets:		
Unrestricted	16,252	13,440
Temporarily restricted	2,885	3,240
Permanently restricted	37,692	38,245
Total net assets	56,829	54,925
Total liabilities and net assets	$ 66,088	$ 65,764

See accompanying notes to financial statements.

EMMA PENDLETON BRADLEY HOSPITAL

Statements of Operations and Changes in Net Assets

Years ended September 30, 2006 and 2005

(In thousands)

		2006		2005
Unrestricted revenues and other support:				
Net patient service revenue	$	47,374	$	47,219
Other revenue		1,082		1,369
Endowment earnings contributed toward community benefit		1,709		1,648
Net assets released from restrictions used for operations		178		120
Net assets released from restrictions used for research		3,021		4,898
Total unrestricted revenues and other support		53,364		55,254
Operating expenses:				
Compensation and benefits		40,227		38,235
Supplies and other expenses		5,147		5,970
Purchased services		5,972		5,672
Provision for bad debts		397		833
Depreciation		1,141		1,122
Total operating expenses		52,884		51,832
Income from operations		480		3,422
Nonoperating gains:				
Net realized gains on sales of investments		—		42
Other nonoperating gains		—		8
Total nonoperating gains, net		—		50
Excess of revenues over expenses	$	480	$	3,472

(Continued)

EMMA PENDLETON BRADLEY HOSPITAL

Statements of Operations and Changes in Net Assets (Continued)

Years ended September 30, 2006 and 2005

(In thousands)

	2006	2005
Unrestricted net assets:		
Excess of revenues over expenses	$ 480	$ 3,472
Other changes in unrestricted net assets:		
Net unrealized gains on investments	6	119
Net assets released from restrictions used for purchase of property and equipment	2,112	582
Change in minimum pension liability	165	(165)
Cumulative effect to October 1, 2005 of change in accounting principle for conditional asset retirement obligations	(23)	—
Increase (decrease) in interest in net assets of Bradley Hospital Foundation	72	(162)
Increase in unrestricted net assets	2,812	3,846
Temporarily restricted net assets:		
Gifts, grants and bequests	2,767	4,990
Income from restricted investments	22	12
Increase in interest in net assets of Bradley Hospital Foundation	108	218
Transfers from Bradley Hospital Foundation	304	301
Net assets released from restrictions	(5,311)	(5,600)
Appropriation from permanently restricted net assets	1,755	439
(Decrease) increase in temporarily restricted net assets	(355)	360
Permanently restricted net assets:		
Net unrealized gains on investments	1,202	1,147
Appropriation to temporarily restricted net assets	(1,755)	(439)
(Decrease) increase in permanently restricted net assets	(553)	708
Increase in net assets	1,904	4,914
Net assets, beginning of year	54,925	50,011
Net assets, end of year	$ 56,829	$ 54,925

See accompanying notes to financial statements.

EMMA PENDLETON BRADLEY HOSPITAL

Statements of Cash Flows

Years ended September 30, 2006 and 2005

(In thousands)

	2006	2005
Cash flows from operating activities:		
Increase in net assets	$ 1,904	$ 4,914
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Change in minimum pension liability	(165)	165
Cumulative effect to October 1, 2005 of change in accounting principle for conditional asset retirement obligations	23	—
Net realized and unrealized gains on investments	(1,208)	(1,308)
Change in undistributed portion of interest in net assets of Bradley Hospital Foundation	(180)	(56)
Transfers from Bradley Hospital Foundation	(304)	(301)
Temporarily restricted gifts, grants and bequests	(2,767)	(4,990)
Depreciation	1,141	1,122
Provision for estimated health care benefit self-insurance costs	4,800	4,043
Decrease in liabilities for estimated health care benefit self-insurance costs resulting from claims paid	(4,666)	(3,869)
Net decrease (increase) in patient accounts receivable	755	(500)
(Decrease) increase in accounts payable	(203)	264
Increase (decrease) in accrued employee benefits and compensation	428	(389)
Increase (decrease) in other accrued expenses	127	(974)
Increase in estimated third-party payor settlements	430	740
Decrease in all other current and noncurrent assets	519	228
Decrease in other liabilities	(2,298)	(1,421)
Net cash used in operating activities	(1,664)	(2,332)
Cash flows from investing activities:		
Purchase of property and equipment	(3,068)	(1,817)
Other net decreases (increases) in assets limited as to use	1,551	(293)
Net cash used in investing activities	(1,517)	(2,110)
Cash flows from financing activities:		
Temporarily restricted gifts, grants and bequests	2,767	4,990
Transfers from Bradley Hospital Foundation	304	301
Net cash provided by financing activities	3,071	5,291
Net (decrease) increase in cash and cash equivalents	(110)	849
Cash and cash equivalents, beginning of year	2,655	1,806
Cash and cash equivalents, end of year	$ 2,545	$ 2,655

See accompanying notes to financial statements.

(1) Description of Organization and Summary of Significant Accounting Policies

(a) Organization

Emma Pendleton Bradley Hospital (the Hospital), whose primary location is East Providence, Rhode Island, is a 60-bed, nonprofit teaching hospital with university affiliation providing for the treatment of emotionally disturbed children. The Hospital operates several major programs including acute, partial hospitalization, residential and outpatient, as well as The Bradley School. The Bradley School provides special education services to children from preschool through high school. The Hospital also operates six other secondary sites which furnish residential and special education services. As a complement to its role in service and education, the Hospital actively supports research. The Hospital is accredited by the Joint Commission on Accreditation of Healthcare Organizations (JCAHO). The Hospital currently participates as a provider in Rhode Island Medicaid, various out of state Medicaid programs, and State of Rhode Island Department of Children and Their Families programs, as well as providing care for patients covered by private health insurers and municipal school departments. The Hospital is also a member of Voluntary Hospitals of America, Inc. (VHA).

Effective March 12, 1996, the Federal Trade Commission and the Health Services Council of the Rhode Island Department of Health approved an affiliation between the Hospital and Lifespan Corporation (Lifespan), a Rhode Island nonprofit corporation, which became the sole corporate member of the Hospital. The Hospital continues to maintain its own identity and Board of Trustees, as well as its own campus and its own name. Lifespan has the responsibility for strategic planning and initiatives, capital and operating budgets and overall governance. The transaction was accounted for as a pooling of interests at the Lifespan level.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid debt instruments with maturities of three months or less when purchased, excluding amounts limited as to use by board-designation or other arrangements under trust agreements.

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

(d) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position. Investments in collective investment funds are measured based on the fair value of the underlying investments. Investments of 5% or more in limited partnerships, limited liability corporations or similar investments are accounted for at fair value, with changes in fair value recorded as realized gains or losses using the equity method. Investments in derivative financial instruments are not material.

Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments other than those accounted for using the equity method are excluded from the excess of revenues over expenses.

Realized gains or losses on sales of investments are determined by the average cost method. Realized gains or losses on unrestricted investments are recorded as nonoperating gains or losses; realized gains or losses on restricted investments are recorded as an addition to or deduction from the appropriate restricted net assets. A decline in the market value of an investment security below its cost that is designated to be other than temporary is recognized through an impairment charge classified as a realized loss and a new cost basis is established.

Lifespan maintains a spending policy for certain board-designated funds of its patient care affiliates which provides that investment income from such funds is recorded within unrestricted revenues as endowment earnings contributed toward community benefit.

(e) Assets Limited As To Use

Assets limited as to use include assets held by a trustee under various irrevocable trusts (Note 6) and assets set aside by the Hospital's Board for future use at its discretion, as well as assets whose use by the Hospital has been limited by grantors or donors to a specific purpose.

(f) Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is computed over the estimated useful life of each class of depreciable asset using the straight-line method. Buildings and improvements lives range from 5 to 40 years and equipment from 3 to 20 years.

(Continued)

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

(g) Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by grantors or donors to a specific purpose, including research activities.

(h) Excess of Revenues Over Expenses

The statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, net assets released from restrictions used for purchase of property and equipment, the change in minimum pension liability, the cumulative effect of change in accounting principle for conditional asset retirement obligations and the change in interest in net assets of Bradley Hospital Foundation.

(i) Net Patient Service Revenue

The Hospital provides care to patients under Medicaid, managed care and commercial insurance contractual arrangements. The Hospital has agreements with many third-party payors that provide for payments to the Hospital at amounts less than its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with some third-party payors.

Most hospital services to Rhode Island Medicaid patients are reimbursed based on negotiated costs under a prospective cost arrangement. The tentative hospital reimbursement rates are determined by certain negotiated budgeted expenditures and budgeted volume. Variances from budgeted volume are reimbursable at rates which may differ from the budgeted rate.

Settlements and adjustments arising under reimbursement arrangements with some third-party payors, primarily Medicaid, are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Hospital has classified a portion of accrued estimated third-party payor settlements as long-term because such amounts, by their nature or by virtue of regulation or legislation, will not be paid within one year. Changes in the Medicaid program, such as the reduction of reimbursement, could have an adverse impact on the Hospital.

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

(j) Provision for Bad Debts

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. Additions to the allowance for doubtful accounts are made by means of the provision for bad debts. Accounts deemed uncollectible are deducted from the allowance and subsequent recoveries are added. The amount of the provision for bad debts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in federal and state governmental health care coverage and other collection indicators.

(k) Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

(l) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. The gifts are reported as temporarily restricted support that increases the net asset class if they are received with stipulations that limit the use of the assets. When a donor or grantor restriction expires, that is, when a stipulated purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions.

(m) Inventories

Inventories, consisting primarily of medical supplies and pharmaceuticals, are stated at the lower of cost or market.

(n) Estimated Self-Insurance Costs

The Hospital participates in Lifespan self-insurance programs with other Lifespan affiliates for losses arising from medical malpractice claims, health benefits to its employees, and effective August 1, 2006, losses arising from workers' compensation claims. The Hospital has recorded provisions for estimated claims, which are based on Lifespan's own experience. The provisions for self-insured losses include estimates of the ultimate costs for both reported claims and claims incurred but not yet reported.

(Continued)

(1) Description of Organization and Summary of Significant Accounting Policies (continued)

(o) Fair Value of Financial Instruments

The carrying amounts recorded in the statements of financial position for cash and cash equivalents, patient accounts receivable, assets limited as to use, accounts payable, accrued expenses, estimated third-party payor settlements, and estimated health care benefit self-insurance costs approximate their respective fair values.

(p) Reclassifications

Certain 2005 amounts have been reclassified to conform with the 2006 reporting format.

(2) Cumulative Effect of Change in Accounting Principle

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47 (FIN 47), "Accounting for Conditional Asset Retirement Obligations". Under FIN 47, costs related to legal obligations to perform certain activities in connection with the retirement, disposal, or abandonment of assets are required to be accrued. The Hospital adopted the provisions of FIN 47 effective October 1, 2005.

The Hospital has identified asbestos abatement as a conditional asset retirement obligation. Asbestos abatement costs were estimated based on relevant facts and circumstances. At September 30, 2006, the Hospital recorded site improvements of $12, related accumulated depreciation of $6, asset retirement obligations of $6 and $23 included in other accrued expenses and other liabilities, respectively, and a cumulative effect of change in accounting principle to October 1, 2005 of $23.

(3) Disproportionate Share

The Hospital is a participant in the State of Rhode Island's Disproportionate Share Program, established in 1995 to assist hospitals which provide a disproportionate amount of uncompensated care. Under the program, Rhode Island hospitals, including the Hospital, receive federal and state Medicaid funds as additional reimbursement for treating a disproportionate share of low income patients. Total payments to the Hospital under the Disproportionate Share Program aggregated $79 and $80 in 2006 and 2005, respectively, and are reflected as part of net patient service revenue in the accompanying statements of operations and changes in net assets.

(In thousands)

(3) Disproportionate Share (continued)

For periods beyond 2006, the federal government could change the level of federal matching funds for the Disproportionate Share Program. Accordingly, it may be necessary for the State of Rhode Island to modify the program and the reimbursement to Rhode Island hospitals under the program. At this time, the scope of such modifications or their effect on the Hospital cannot be reasonably determined.

(4) Charity Care and Community Services

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and the estimated cost of those services and supplies.

The following information measures the level of charity care provided by the Hospital during the years ended September 30:

	2006	2005
Charges forgone, based on established rates	$ 228	$ —
Estimated costs and expenses incurred to provide charity care	$ 179	$ —

The Hospital provides numerous services to the community for which charges are not generated. These services include emergency interventions and referrals, mental health education, patient education, patient advocacy and community awareness programs.

The Hospital also subsidizes the cost of treating patients who receive government assistance where reimbursement is below cost.

In addition to the cost of charity care and community service programs, the Hospital provided $397 and $833 for uncollectible patient accounts, based on charges net of contractual allowances, during the years ended September 30, 2006 and 2005, respectively. The cost associated with such provisions approximated $312 and $646 in 2006 and 2005, respectively.

(In thousands)

(5) Investments

The composition of assets limited as to use at September 30, 2006 and 2005 is set forth in the following table.

	2006	2005
Internally board-designated:		
U.S. government and agency obligations	$ 101	$ 129
Corporate equity securities	844	814
Corporate obligations	183	179
Collective investment funds	1,407	1,140
	2,535	2,262
Temporarily restricted funds:		
Cash and short-term investments	1,526	1,589
Permanently restricted funds:		
Cash and short-term investments	604	416
U.S. government and agency obligations	3,043	4,387
Corporate equity securities	20,590	20,189
Corporate obligations	10,456	10,254
Real estate	2,969	2,969
	37,662	38,215
Total	$ 41,723	$ 42,066

(Continued)

(In thousands)

(5) Investments (continued)

Investment income, gains and losses for cash equivalents and assets limited as to use are comprised of the following for the years ended September 30:

		2006		2005
Other revenue:				
Interest income	$	110	$	38
Endowment earnings contributed toward community benefit:				
Investment income	$	1,709	$	1,648
Nonoperating gains and losses:				
Net realized gains on sales of investments	$	—	$	42
Other changes in unrestricted net assets:				
Net unrealized gains on investments	$	6	$	119
Changes in temporarily restricted net assets:				
Income from restricted investments	$	22	$	12
Changes in permanently restricted net assets:				
Net unrealized gains on investments	$	1,202	$	1,147

The following criteria are considered in determining other than temporary declines in the fair market value of individual investments:

- The unrealized loss must be present for at least a nine-month period, with a fair market value/cost ratio of less than 75% at both the beginning and end of the period.
- Investments with a fair market value/cost ratio of 25% or less are written down immediately.
- Investments for which the manager has increased the position by at least 20% in the last nine months are not adjusted unless the fair market value/cost ratio is 25% or less; otherwise, these investments are monitored for possible adjustment in future periods.
- Investments whose fair market value/cost ratio is below 75% at the beginning of a nine-month period but above 65% at the end of said period are not adjusted but rather monitored for possible adjustment in future periods.

(Continued)

(In thousands)

(5) Investments (continued)

Information regarding investments with unrealized losses at September 30, 2006 and 2005 is presented below, segregated between those that have been in a continuous unrealized loss position for less than twelve months and those that have been in a continuous unrealized loss position for twelve or more months:

	Less than 12 months		12 months or longer		Total	
September 30, 2006:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Internally board-designated funds:						
U.S. government and agency obligations	$ 40	$ 1	$ 43	$ 1	$ 83	$ 2
Corporate obligations	24	1	34	1	58	2
Total debt securities	64	2	77	2	141	4
Corporate equity securities	65	8	31	5	96	13
Collective investment funds	126	8	10	1	136	9
Total temporarily impaired securities	$ 255	$ 18	$ 118	$ 8	$ 373	$ 26

	Less than 12 months		12 months or longer		Total	
September 30, 2005:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Internally board-designated funds:						
U.S. government and agency obligations	$ 100	$ 2			$ 100	$ 2
Corporate obligations	50	1			50	1
Total debt securities	150	3			150	3
Corporate equity securities	65	7	$ 21	$ 5	86	12
Total temporarily impaired securities	$ 215	$ 10	$ 21	$ 5	$ 236	$ 15

(In thousands)

(5) Investments (continued)

The following table sets forth changes in internally board-designated investments for the years ended September 30, 2006 and 2005:

	2006	2005
Internally board-designated investments at beginning of year	$ 2,262	$ 1,944
Investment income:		
Dividend and interest income	40	42
Net realized gains on sales of securities	197	157
Net unrealized gains on investments	6	119
Deposits	30	—
Internally board-designated investments at end of year	$ 2,535	$ 2,262

(6) Assets Held in Trust

The Hospital is a beneficiary of various irrevocable trusts. The fair market value of these investments at September 30, 2006 and 2005 was approximately $37,662 and $38,215, respectively, and is reported as permanently restricted funds within assets limited as to use in the statements of financial position.

(7) Property and Equipment

Property and equipment, by major category, is as follows at September 30:

	2006	2005
Land and improvements	$ 1,014	$ 1,014
Buildings and improvements	16,458	15,451
Equipment	9,757	9,041
	27,229	25,506
Less accumulated depreciation	15,028	13,890
	12,201	11,616
Construction in progress	2,200	858
Property and equipment, net	$ 14,401	$ 12,474

(7) Property and Equipment (continued)

Depreciation expense for the years ended September 30, 2006 and 2005 amounted to $1,141 and $1,122, respectively.

The land and the original Laufer Building in East Providence, Rhode Island where the Hospital is located are assets of the trust established under the terms of the will of the late George L. Bradley, and are therefore not included within the Hospital's property and equipment but are included in assets held in trust (see Note 6).

The estimated cost of completion of construction in progress approximated $67 at September 30, 2006, comprised mainly of various building renovation projects.

(8) Pension Benefits

Lifespan Corp. sponsors the Lifespan Corporation Retirement Plan (the Plan), which was established effective January 1, 1996, when the Rhode Island Hospital Employee Retirement Plan merged into The Miriam Hospital Retirement Plan. Upon completion of the merger, the new plan was renamed and is governed by provisions of the Lifespan Corporation Retirement Plan. Effective January 1, 1997, the Emma Pendleton Bradley Hospital Retirement Plan (the Bradley Plan) merged into the Plan. Each employee who was a participant in the Bradley Plan and was an eligible employee on January 1, 1997 continues to be a participant on and after January 1, 1997, subject to the provisions of the Plan. Employees are included in the Plan on the first of the month which is the later of their first anniversary of employment and the attainment of age 18.

The Plan is intended to constitute a plan described in Section 414(k) of the Internal Revenue Code, under which benefits are derived from employer contributions based on the separate account balances of participants in addition to the defined benefits provided under the Plan, which are based on an employee's years of credited service and annual compensation. Lifespan's funding policy is to contribute amounts to the Plan sufficient to meet minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as may be determined to be appropriate by Lifespan.

Substantially all employees of Lifespan Corporation who meet the above requirements are eligible to participate in the Plan. Lifespan uses a measurement date of June 30 for the Plan.

(In thousands)

(8) Pension Benefits (continued)

Benefit Obligations

	2006	2005
Change in benefit obligation:		
Benefit obligation, beginning of year	$ 363,010	$ 303,766
Service cost	21,198	17,743
Interest cost	19,495	19,607
Benefits paid	(16,701)	(14,310)
Administrative expenses	(1,065)	(1,092)
Actuarial (gain) loss	(37,825)	37,296
Projected benefit obligation at end of year	$ 348,112	$ 363,010

The accumulated benefit obligation at the end of 2006 and 2005 was $300,221 and $306,904, respectively.

The following assumptions were used to determine end of year benefit obligations:

	2006	2005
Weighted-average discount rate	6.25%	5.0%
Rate of increase in future compensation levels	4.5%	4.5%

Plan Assets

	2006	2005
Change in plan assets:		
Fair value of plan assets, beginning of year	$ 265,119	$ 241,427
Actual return on plan assets	32,251	22,857
Employer contributions	18,512	16,237
Administrative expenses	(1,065)	(1,092)
Benefits paid	(16,701)	(14,310)
Fair value of plan assets, end of year	$ 298,116	$ 265,119

Employer contributions and benefits paid in the above table include only those amounts contributed directly to or paid directly from Plan assets.

(In thousands)

(8) Pension Benefits (continued)

The asset allocation for the Plan at June 30, 2006 and 2005, and the target allocation for 2007, by asset category, are as follows:

Asset Category	Target Allocation 2006	Percentage of Plan Assets at June 30 2006	2005
U.S. equity	25-40%	23.4%	26.7%
Absolute return	0-15%	9.9%	7.9%
International equity	10-30%	26.1%	22.9%
Venture capital	0-10%	1.8%	1.8%
Commodities	0-10%	11.5%	10.1%
Real estate	0-15%	8.6%	8.0%
Fixed income	15-35%	18.7%	19.5%
Cash and cash equivalents	0-10%	—	3.1%
Total		100.0%	100.0%

The above table does not include $56,033 and $48,676 of Plan assets at June 30, 2006 and 2005, respectively, attributable to the separate savings account balances of participants which are managed in various mutual funds by Fidelity Investments.

The overall financial objective of the Plan is to meet present and future obligations to beneficiaries, while minimizing long-term contributions to the Plan (by earning an adequate return on Plan assets), with moderate volatility in year-to-year contribution levels.

The primary investment objective of the Plan is to provide a satisfactory return on investment in support of the above objective. The Plan's specific investment objective is to attain an average annual real total return (net of investment management fees) of at least 5% over the long term (rolling five-year periods). Real total return is the sum of capital appreciation (or loss) and current income (dividends and interest) adjusted for inflation by the Consumer Price Index.

(In thousands)

(8) Pension Benefits (continued)

Funded Status

The funded status of the Plan, reconciled to the amount reported on Lifespan's consolidated statements of financial position, follows:

	2006	2005
Fair value of plan assets	$ 298,116	$ 265,119
Benefit obligations	348,112	363,010
Funded status	(49,996)	(97,891)
Unrecognized net loss from past experience different from that assumed	8,733	62,506
Prior service cost not yet recognized in net periodic pension cost	5,693	6,693
Net pension liability recognized in Lifespan's consolidated statements of financial position	$ (35,570)	$ (28,692)
Net pension liability recognized in the Hospital's statements of financial position	$ (2,502)	$ (2,047)

The net pension liability recognized in the Hospital's statements of financial position at September 30, 2006 and 2005 consists of:

	2006	2005
Current (included in accrued employee benefits and compensation)	$ 1,160	$ 839
Noncurrent (included in other liabilities)	1,342	1,208
Total	$ 2,502	$ 2,047

(In thousands)

(8) Pension Benefits (continued)

At the end of 2006 and 2005, the projected benefit obligation, accumulated benefit obligation, and fair value of plan assets were as follows:

	2006	2005
Projected benefit obligation	$ 348,112	$ 363,010
Accumulated benefit obligation	300,221	306,904
Fair value of plan assets	298,116	265,119

Expected Cash Flows

Information about the expected cash flows for the Plan follows:

Employer contributions:	
2007 (expected)	$ 24,990
Expected benefit payments:	
2007	$ 17,400
2008	18,300
2009	20,200
2010	20,700
2011	23,100
2012-2016	146,800

Management evaluates its Plan assumptions annually and the expected contribution in 2007 could increase.

(In thousands)

(8) Pension Benefits (continued)

Net Periodic Pension Cost

Components of net periodic pension cost are as follows for the years ended September 30:

	2006	2005
Service cost	$ 21,198	$ 17,743
Interest cost	19,495	19,607
Expected return on plan assets	(20,766)	(18,922)
Net amortization and deferral	5,463	3,103
Net periodic pension cost for Lifespan	$ 25,390	$ 21,531
Net periodic pension cost for the Hospital	$ 1,296	$ 1,086

The following assumptions were used to determine net periodic pension cost:

	2006	2005
Weighted-average discount rate	5.0%	6.25%
Expected long-term rate of return on plan assets	8.0%	8.0%
Rate of increase in future compensation levels	4.5%	4.5%

Lifespan employs a rigorous process to annually determine the expected long-term rate of return on Plan assets which is only changed based on significant shifts in economic and financial market conditions. These estimates are primarily driven by actual historical asset-class returns along with our long-term outlook for a globally diversified portfolio. Asset allocations are regularly updated based on evaluations of future market returns for each asset class.

(In thousands)

(8) Pension Benefits (continued)

Lifespan and the Hospital recorded a change in minimum pension liability of $6,400 and $165, respectively, at September 30, 2005, as required by Financial Accounting Standards Board Statement No. 87. The adjustment is prescribed when the accumulated benefit obligation of a pension plan exceeds the fair value of underlying pension plan assets in an amount greater than accrued pension liabilities. The adjustments referenced above were comprised of:

	Lifespan	The Hospital
Minimum pension liability included in other liabilities	$ (13,093)	$ (227)
Intangible pension asset included in other noncurrent assets	6,693	62
Net charge to unrestricted net assets	$ (6,400)	$ (165)

In 2006, the net minimum pension liability of $165 was reversed since the excess of accumulated benefit liabilities over Plan assets is less than the net pension liability recognized in the statements of financial position.

New Accounting Pronouncement Re: Pension and Other Postretirement Benefit Plans

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans". FASB Statement No. 158, which is an amendment of FASB Statements No. 87, 88, 106, and 132R, requires an employer to recognize in its statement of financial position an asset for a benefit plan's overfunded status or a liability for a plan's underfunded status, with a corresponding increase or decrease in unrestricted net assets. The funded-status amount will be measured as the difference between the fair value of plan assets and the benefit obligation including all actuarial gains and losses and prior service cost.

The requirement to recognize the funded status of Lifespan's benefit plans is effective as of September 30, 2007. Based on the September 30, 2006 funded-status amount for the Hospital's portion of the Lifespan Corporation Retirement Plan, the Hospital would record a decrease in unrestricted net assets of $108 in 2007.

(In thousands)

(9) Patient Service Revenue and Related Reimbursement

A major portion of the Hospital's revenue is received from third-party payors. The following is an approximate percentage breakdown of gross patient service revenue by payor type for the years ended September 30:

	2006	2005
Medicaid and Rite Care	56%	55%
Municipal school departments	19	20
Blue Cross	11	13
Managed care	10	9
All other	4	3
	100%	100%

The Hospital grants credit to patients, most of whom are local residents. The Hospital generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicaid, Blue Cross, managed care, and commercial insurance policies).

Cost reports filed annually with third-party payors are subject to audit prior to final settlement. The 2004 through 2006 cost reports have not been filed and, therefore, not settled with Medicaid.

Regulations in effect require annual settlements based upon cost reports filed by the Hospital. These settlements are estimated and recorded in the accompanying financial statements. Changes in these estimates are reflected in the financial statements in the year in which they occur.

Revenues from Medicaid programs accounted for approximately 56% of the Hospital's gross patient service revenue for the year ended September 30, 2006. Laws and regulations governing Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations. Compliance with laws and regulations can be subject to future government review and interpretation as well as significant regulatory action; failure to comply with such laws and regulations can result in fines, penalties and exclusion from Medicaid programs.

(10) Income Tax Status

The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from Federal income taxes pursuant to Section 501(a) of the Code.

(In thousands)

(11) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30:

	2006	2005
Research	$ 1,332	$ 1,613
General health care service activities	239	421
Interest in net assets of Bradley Hospital Foundation	1,314	1,206
Total	$ 2,885	$ 3,240

Permanently restricted net assets are restricted in perpetuity at September 30, the income from which is expendable to support the following:

	2006	2005
General health care service activities	$ 37,692	$ 38,245

(12) Leases

The Hospital leases building space and equipment under various noncancelable operating lease agreements. Future minimum lease payments, by year and in the aggregate, under noncancelable operating leases with terms of one year or more consist of the following at September 30, 2006:

Year Ending September 30:	Amount
2007	$ 449
2008	95
2009	56
2010	30
2011	1
Total minimum lease payments	$ 631

Rental expense, including rentals under leases with terms of less than one year, for the years ended September 30, 2006 and 2005 was $519 and $558, respectively.

(13) Concentrations of Credit Risk

Financial instruments which potentially subject the Hospital to concentrations of credit risk consist primarily of accounts receivable and certain investments. The risk associated with temporary cash investments is mitigated by the fact that the investments are placed with what management believes are high credit quality financial institutions. Investments, which include government and agency obligations, stocks, and corporate bonds, are not concentrated in any corporation or industry.

The Hospital receives a significant portion of its payments for services rendered from a limited number of government and commercial third-party payors, including Medicaid, municipal school departments, Blue Cross, and various managed care entities. The Hospital has not historically incurred any significant concentrated credit losses in the normal course of business.

(14) Malpractice and Other Litigation

Professional Liability/Medical Malpractice

Professional liability/medical malpractice coverage for the Hospital is supplied on a claims-made basis by Rhode Island Sound Enterprises Insurance Co., Ltd. (RISE), Lifespan's affiliated captive insurance company, which underwrites the medical malpractice risk of the Hospital. The adequacy of the coverage provided and the funding levels are reviewed annually by independent actuaries and consultants. The professional liability insurance provided by RISE has liability limits of $4,000 per claim with no annual aggregate. RISE provides a second layer of coverage which has limits of an additional $2,000 per claim with a $2,000 annual aggregate. In addition, commercial umbrella excess insurance has been obtained by Lifespan to increase the professional liability limits to $22,000 per claim.

The Hospital has been named as a defendant in a number of pending actions seeking damages for alleged medical malpractice. In the opinion of management, any liability and legal defense costs resulting from these actions will be within the limits of the Hospital's malpractice insurance coverage provided by RISE and/or commercial excess carriers.

General Liability

General liability coverage is provided to the Hospital by RISE amounting to $4,000 per claim and $4,000 in the annual aggregate. Commercial excess liability insurance has been obtained by Lifespan which provides aggregate general liability coverage of $80,000.

(Continued)

(In thousands)

(14) Malpractice and Other Litigation (continued)

Workers' Compensation

The Hospital has incurred a number of workers' compensation claims and, in the opinion of management, the liability of the Hospital will be within the limits of the assets of Lifespan's workers' compensation self-insurance trust fund.

Other Litigation

The Hospital is also involved in a number of miscellaneous suits and general liability suits arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

(15) Related-Party Transactions

The Hospital was charged a management fee by Lifespan of $4,423 and $4,333 in 2006 and 2005, respectively, representing approximately 5% of Lifespan's operating expenses in each year. Lifespan provides information services, human resources, financial, and various other support services to the Hospital.

Included in other receivables, other accrued expenses and other liabilities are the following amounts due from (to) certain related entities at September 30:

	2006	2005
Other receivables:		
RIH	$ 50	$ —
Other accrued expenses:		
RIH	$ —	$ (36)
Other liabilities:		
Lifespan	$ (251)	$ (2,439)

During the years ended September 30, 2006 and 2005, the Hospital received temporarily restricted net asset transfers from Bradley Hospital Foundation (the Foundation) amounting to $304 and $301, respectively.

(In thousands)

(15) Related-Party Transactions (continued)

The Foundation, whose sole corporate member is Lifespan Corporation, was established to engage in philanthropic activities to support the mission and purposes of Lifespan and the Hospital. Funds are distributed to the Hospital when purpose restrictions stipulated by donors are accomplished. A summary of the Foundation's assets, liabilities, net assets, results of operations, and changes in net assets follows. The Hospital's interest in the net assets of the Foundation is reported as a noncurrent asset in the statements of financial position.

	2006	2005
Assets, principally assets limited as to use	$ 1,509	$ 1,355
Liabilities	$ 1,149	$ 1,175
Unrestricted net deficit	(954)	(1,026)
Temporarily restricted net assets	1,314	1,206
Total liabilities and net assets	$ 1,509	$ 1,355
Total unrestricted revenues, gains and other support	$ 391	$ 219
Total expenses	326	435
Excess (deficiency) of revenues over expenses	65	(216)
Other increases in unrestricted net assets	7	54
Unrestricted net deficit, beginning of year	(1,026)	(864)
Unrestricted net deficit, end of year	$ (954)	$ (1,026)
Increase in temporarily restricted net assets	$ 108	$ 218
Temporarily restricted net assets, beginning of year	1,206	988
Temporarily restricted net assets, end of year	$ 1,314	$ 1,206

There are no amounts payable from the Foundation to the Hospital at the end of 2006 and 2005.

Included in the Foundation's liabilities are the following amounts due to certain related entities at September 30:

	2006	2005
Lifespan	$ 1,060	$ 1,172

(In thousands)

(16) Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows for the years ended September 30:

	2006	2005
Health care services	$ 42,766	$ 39,916
Research	3,759	5,827
General and administrative:		
Depreciation	1,141	1,122
Other	5,218	4,967
Total general and administrative	6,359	6,089
	$ 52,884	$ 51,832

EMMA PENDLETON BRADLEY HOSPITAL

Financial Statements

September 30, 2006 and 2005

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KPMG LLP
50 Kennedy Plaza
Providence, RI 02903-2321

Independent Auditors' Report

The Board of Trustees
Emma Pendleton Bradley Hospital:

We have audited the accompanying statements of financial position of Emma Pendleton Bradley Hospital (the Hospital) as of September 30, 2006 and 2005, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Emma Pendleton Bradley Hospital as of September 30, 2006 and 2005, and the results of its operations and changes in net assets, and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

January 29, 2007